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STARR AUSTEN & MILLER, LLP

Do You Have a Case?

Securities Case

eBooklet

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Are you dealing with a security?

The definition of a "security" under the Indiana Securities Act includes:

- Notes
- Stocks
- Security futures
- Bonds
- Evidence of indebtedness
- Transferable shares
- Puts, calls, and straddles
- Options
- Investment contracts

These are NOT securities under the Indiana Securities Act:

- Does NOT include Government issued securities.
- Does NOT include an insurance policy or annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or another specified period.
- Does NOT include bank or credit unions CDs or savings accounts

Was fraud committed?

It is unlawful for a person, in connection with the sale of a security, directly or indirectly, to (1) employ a device, scheme, or artifice to defraud; (2) to make an untrue statement of material fact or to omit a material fact necessary in order to make the statement made, in light of the circumstances under which they were made, not misleading; or (3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person. Proof of reliance on the untrue statement is not required under the Indiana Securities Act.

What Does Standard of Care Mean, and Who Has to Follow it?

As it relates to investment matters, standard of care refers to how investment professionals – including investment advisors, Registered Investment Advisors, and brokers — render service to their clients. Good standard of care means these professions serve their client's best interests with the intent of eliminating or exposing all potential conflicts of interest, in which advice could be rendered that is not in the best interest of the client.

What are Self-Directed IRAs?

Self-directed IRAs are a type of financial instrument which allows a person to invest in a larger range of assets than a traditional IRA. Many of us are familiar with IRAs that invest in stocks, bonds, mutual funds, and certificates of deposit, but self-directed IRAs expand from these more traditional investing avenues, and also allow someone to invest in promissory notes, real estate, precious metals, private placement securities, tax lien certificates, and other investments which may not be registered.

This type of IRA is becoming increasingly popular in the United States, with about $94 billion of retirement funds invested in them. They are completely legal, when used correctly. However, some of the inherent characteristics of this financial instrument have not only attracted legitimate investments, but in addition scammers and fraudsters who use the patina of the self-directed IRAs legality to defraud investors of their life savings.

Why are Self-Directed IRAs so susceptible to fraud?

As with all IRAs, a self-directed IRA must be held by a trustee or custodian. However, with the more traditional IRAs the custodians are typically banks and broker-dealers who only allow investment in firm approved stocks, bonds, mutual funds and CDs. However, with a self-directed IRA the trustee or custodian's duties may be more lax.

The fact that this type of IRA allows investment in a broader range of assets can increase the likelihood of fraudulent behavior. For example, unregistered securities are permitted in this type of IRA. There is typically less investigation into this type of security, with less information easily available, and further there is no guarantee that any information provided has been audited. Therefore, in a situation in which more due diligence is typically required there is less opportunity to review accurate information to perform that due diligence.

In addition, the broader range of assets allowed for self-directed IRAs can create unique risks for investors that should be considered, such as lack of liquidity and difficulty in valuing assets. The result of the characteristics of these assets means that the self-directed IRA custodians will often list the value of the assets as the original purchase price, plus any gains as determined arbitrarily by the promoter. These values that are told to investors may not reflect the true value of the investment if sold on the open market. Further, these self-promoting statements may go unchecked and unquestioned.

Finally, the fact that self-directed IRAs are a tax-deferred account can impact psychologically how much oversight an investor has over this type of investment instrument. The fact that there is a financial penalty for early withdrawal means people tend to invest in these types of accounts for the long term, when more prudent investors in these types of investments may more actively manage such accounts. This same mind set may also allow the person committing the Ponzi type scheme or other fraud to conduct their fraud longer before their misdeeds are detected.

Scott Starr, a partner in this firm, has stated, “Some of these investment advisors and stockbrokers are clearly committing malpractice and breaching their fiduciary duties” when directing individuals to invest in these self-directed IRAs. Further, he states that “It is not uncommon for these individuals to place their clients in investments that are either too high risk, carry a time horizon that is too far in the future, or fail to properly diversify these portfolios.”

What are some examples of Self-Directed IRA Fraud?

Although fraudulent actions surrounding self-directed IRAs can, unfortunately, happen anywhere in the country the state of Indiana, and surrounding states, have had several instances of this type of fraud coming to light.

1. Randell Morrison – Indiana

One of the most recent cases of self-directed IRA fraud reported in Indiana is the case of Randell Morrison, which has been reported extensively in the Fort Wayne, Indiana Journal Gazette. On November 10, 2011, Mr. Morrison was sentenced to six years in prison, followed by a year of home detention and then one year of probation for bilking 15 investors in Indiana, mainly in the Allen County area, out of $1.4 million.

Mr. Morrison was a businessman in the community, and used his personal associations with fraud victims, including being a friend of the family, and attending country clubs, churches and social clubs with them, to gain their trust over several years. He then convinced these investors to roll their more traditional IRAs and life insurance proceeds into a self-directed IRA custodial company, called Equity Trust, with which he was associated. His victims thought they were investing their money in conservative and traditional investments, but instead once he gained control of the money he used it for his own personal use and for his businesses.

The Indiana Secretary of State, Charlie White, said, “Randell Morrison preyed on those who considered him a friend. He didn’t just gamble with their life savings, he squandered their life savings.” Many of the victims of this scheme were close to retirement age, and have now lost their entire retirement account and life savings. They have suffered not only financial losses, but also emotional and even physical distress because of the fraud perpetuated against them.

2. Jerry Smith and Jason Snelling – Indiana

Another case in Indiana that is currently pending involves Jerry Smith and Jason Snelling, who are accused of conducting a long-running Ponzi scheme, defrauding investors in three states, Indiana, Ohio and Kentucky, of over $4.5 million. Smith and Snelling were allegedly selling unregistered securities, and neither was licensed to sell them.

In this case the accusation is that investors were convinced and encouraged to roll over their traditional IRA accounts into self-directed IRAs at a trust company. Then, Smith and Snelling allegedly took the funds from the accounts and used them for their own personal use. The investors had no idea their money was no longer available, since they still received regular statements from the trust company, and even were billed fees on the accounts.

Smith and Snelling are charged with over 50 counts of violations of the Indiana Uniform Securities Act, and charges are pending in both Franklin County and Dearborn County, Indiana.

What is FINRA arbitration?

Nearly all national brokerage companies and many larger regional stock brokerage firms require their customers to sign FINRA arbitration agreements as a condition upon you doing business with their company. This means that if you, for any reason, need to sue your investment advisor, stock broker, and/or company for either fraud or investment malpractice, you will not be able to do so in court, and instead must use the FINRA arbitration process and hire a securities arbitration lawyer. In general, the FINRA arbitration process works as follows:

Start an Arbitration

To start an arbitration, the lawyer for the investor (known as the claimant) files a “statement of claim” and other arbitration forms with FINRA. FINRA then serves the claim on the stock brokers or financial advisors (known as the respondents) that are being sued. Respondents then file an answer to the claim, which usually denies responsibility for the conduct and losses described in the claim.

Select the Panel

The attorneys for both sides receive a list of 30 potential arbitrators on three different lists, known as Chair Qualified, Public and Non-Public. The claimant can now insist on all public arbitrators. Each side ranks and strikes the names on the list, based upon their knowledge of and experience with the arbitrators. From the ranked lists prepared by each side, FINRA selects a panel of three arbitrators. Once the panel is selected, FINRA schedules an Initial Prehearing Conference (IPHC). The IPHC is a telephone conference between the arbitrators and the attorneys for the parties. At the IPHC, the parties agree upon the length and dates for the hearing that will decide the claims.

Review the Evidence

To prepare for the hearing that will decide the case, both sides participate in “discovery of the evidence”. The parties exchange pertinent documents and information that is needed to present, argue and decide the case. Each side provides the others with relevant records that may be used at the hearing. It’s your opportunity to look at records you may have wondered about but could not obtain, such as information about how much money a financial advisor made from your portfolio.

Call Witnesses

Twenty days before the hearing begins, each side must tell the other who will be called as witnesses. At that time, they will also provide copies of all the exhibits they intend to offer at the hearing not already exchanged during the discovery process.

Hold the Arbitration Hearing

The arbitration hearing takes place in a conference room in a hotel or office suite, or at the FINRA offices, usually in the city where you lived when the investment problems arose. Hearings begin with opening statements by each side. Then we call our witnesses and offer our exhibits. After we have finished presenting our case, the brokerage firm presents its witnesses and exhibits.

Each side gets to cross examine witnesses and make objections. When all witnesses have been called, the lawyers each give closing arguments. The arbitration panel closes the hearing, and issues a written award, usually within a week or two. The stock brokerage firm or financial advisors have 30 days to pay any award made against them. If they fail to do so, they lose their securities license.

When can I bring an action in court?

FINRA arbitration is only required where the customer has signed an agreement waiving his rights to file a lawsuit in court and instead requiring him to file a FINRA arbitration. While most national and regional brokerage firms do require customers to sign FINRA arbitration agreements (because frankly brokerage firms believe the customers are treated less fairly in FINRA arbitration) many independent investment advisors, bank trust departments, life insurance salespersons, and some annuity salespersons do not require that FINRA arbitration agreements be executed by their customers in advance of them purchasing these types of investments.

Is your claim barred by the statute of limitation?

The statute of limitation for civil actions under the Indiana Securities Act is 3 years after the date of discovery by the person bringing the action of the violation of the act. For a securities FINRA arbitration action, the statute of limitations is 6 years.

If you have any questions or would like to discuss your case, please contact me.

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